Submission to the Ministry of Business, Innovation & Employment

Russell McVeagh

Targeted Review of the Commerce Act 1986

9 February 2016

1. INTRODUCTION

1.1 This submission, on the Ministry of Business, Innovation & Employment's (the "**Ministry**") targeted review of the Commerce Act 1986 issues paper ("**Issues Paper**"), is made by Russell McVeagh.

1.2 Russell McVeagh's view is that there is insufficient evidence that the current formulation of s36 of the Commerce Act 1986 ("**Commerce Act**") is not effective, and its implementation by the courts does not appear to be materially out of alignment with other relevant jurisdictions. To that end, Russell McVeagh does not support changes to that section unless there are also changes made in Australia, in which case the benefits of consistency may outweigh the lack of benefit of a change in the law. Russell McVeagh does not support the introduction of market studies powers.

1.3 Our comments in this submission are designed to assist the Ministry to make recommendations that best achieve the purpose of the Commerce Act. In particular, we focus on whether proposed changes will enable parties to assess, with reasonable certainty in advance, whether their conduct will breach the Commerce Act (or not) and whether proposed changes will promote competition and protect consumers.

1.4 Russell McVeagh is available to make an oral presentation to the Ministry and its officials if requested.

1.5 All enquiries on this submission may be directed to:

2. EXECUTIVE SUMMARY

2.1 Russell McVeagh supports the Ministry's initiative to seek feedback on whether further investigation of the Commerce Act's operation is required.

2.2 Our submissions are designed to assist the Ministry to determine whether further investigation of the Commerce Act's operation is required. Our recommendations are aimed at providing certainty and clarity for businesses on the scope of the Commerce Act, in order to best achieve pro-competitive outcomes, entrepreneurship, innovation and productivity in the best interests of the New Zealand economy as a whole.

2.3 Our key submissions are as follows:

Market power reform

(a) We agree with many of the fundamental tenets of the Ministry's position, including that:

- businesses striving to acquire market power encourages innovation, and firms should not be punished when they

attain it. Nor, having acquired market power, should they be prevented from competing or innovating further. Consumers benefit from increased productivity and innovation of both large and small businesses; and

- it is not the purpose of the market power provision to protect small businesses, or any particular category of competitor, but rather to protect the competitive process.

(b) We are concerned that the description of the issues by the Ministry has, in parts, not properly captured the practice or context of enforcement of s36 in its current form. In particular:

- The Commerce Act contains a number of rules against anticompetitive exclusionary conduct, not only as set out in s36. The prohibitions against anticompetitive agreements (s27) and against cartels (s30) also prohibit anticompetitive exclusionary conduct.

- The description in the Issues Paper of the s36 rule and its implementation by the courts is distorted by a lack of reference to the enforcement track record of s27, which, in practice, is often brought as a parallel cause of action in combination with s36 (including in all four Commerce Act investigation reports published by the NZCC on its website) and applies the substantial lessening of competition ("**SLC**") test that is under consideration for s36. The Issues Paper fails to explain the interrelationship between the concepts of market power, workably competitive markets and a substantial lessening of competition (which was highlighted by the Supreme Court in *0867* in deciding, including on policy grounds, not to accept the Commerce Commission's ("**NZCC**") invitation to move away from the counterfactual test).[1] The concepts of market power and substantial lessening of competition have been described as "two sides of the same coin".[2] An increase in market power is the same as a lessening of competition.[3]

- As a result, a market where a participant has market power is not a workably competitive market. In those circumstances, to distinguish between competition "on the merits" and behaviour that harms competition it is conceptually useful, and the practice of courts (as found by the Supreme Court on analysis of the Australian authorities), to consider what that business would have done in a (necessarily hypothetical) competitive market.

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[1] *Commerce Commission v Telecom Corporation of New Zealand Ltd* (2008) 8 NZBLC 102, 239; *Commerce Commission v Telecom Corporation of New Zealand* [2009] NZCA 338; *Commerce Commission v Telecom Corporation of New Zealand Limited* [2010] NZSC 111, (collectively "***0867***").

[2] NZCC *Decision No 456 - Shell New Zealand Limited v The Gas Company Limited* (1 March 2002) at [68]. "For the purposes of the analysis, the Commission takes the view that a lessening of competition and a strengthening of market power may be taken as being equivalent, since they are the two sides of the same coin."

[3] See NZCC Merger and Acquisition Guidelines (24 July 2013), available at: http://www.comcom.govt.nz/dmsdocument/10188.

- Categorising jurisdictions as having an "effects test" (or not), confuses rather than illuminates the discussion. Two separate effects are relevant when considering prohibitions on misuse of market power, an "exclusionary effect" and any "effect on market" (or "whole of market" or "SLC effect").

- As the Ministry notes, the European Union ("**EU**") and United States ("**US**") market power tests broadly consider, first, whether the conduct in question has given rise to an "exclusionary effect" - which focuses on the impact of the (large business') behaviour on the (smaller) competitor. Defences are then available to show an efficiency or legitimate business rationale (the "SLC effect") - although in practice it is rare for the European Commission to accept efficiency justifications.

- In New Zealand, if a firm with market power engages in conduct that has an "exclusionary effect", that will meet the s36 purpose test, because the effect of the conduct is used to infer purpose. The business with market power then has an evidential burden (if not a legal burden) to demonstrate its legitimate business rationale, ie that it would have behaved the same way even without market power. In this way the "taking advantage" test assesses whether, at the time the larger business took the steps it did, its conduct amounted to competition "on the merits", ie it can be assumed to be neutral or pro-competitive because it was what a business without market power in a competitive market would have done (this acts as a proxy for "no SLC effect", but generally provides a better degree of predictability for the business considering its available courses of action).

- The "taking advantage" requirement is not misaligned with the other prohibitions in the Commerce Act or the equivalent prohibitions overseas - it creates the necessary causal connection between having market power (ie being big) and the exclusionary outcome (ie acting with the purpose of preventing or deterring competition):

    - Sections 27 and 47 similarly require a causal connection between a triggering cause (in those provisions either a contract, arrangement or understanding or a business acquisition) and the "effect on market".

    - The efficiency/business rationale defences in the EU and US are a proxy for the "taking advantage" requirement - ie if there is a legitimate business rationale then the market power itself is not the cause of any "exclusionary effect".

  Removing the "taking advantage" requirement would make s36 the outlier.

(c) We broadly agree with the Ministry's assessment criteria. However, the sophistication and complexity of the multiplicity of markets across the business spectrum to which the prohibition applies means that, no matter how simple the rule may be in concept, the Productivity

Commission's desire that there be a rule that "offers greater accuracy in identifying situations where a taking advantage has occurred" is unrealistic. Unilateral conduct / misuse of market power actions are internationally recognised as the most difficult area of Commerce Act enforcement - there is no "silver bullet".

(d) We agree the tools at the NZCC's disposal are not effective, when measured by the extent to which they are used. Opinions may differ as to the cause of that (see Box 1 below). We do not, however, agree that it is appropriate for the Ministry to limit its consideration of the need for reform of s36 by reference only to the manner in which the courts have applied that law (after all, the courts can only consider cases that are brought before them). For example, the NZCC has published three recent reports, which are available on its website, on its findings after investigations conducted under s36, and these are also relevant to the Ministry's consideration of enforcement of that section.

(e) We do not agree the track record of enforcement as set out in the appendices to the Ministry's issues paper demonstrates that s36 fails to punish anticompetitive conduct by powerful firms. For example, reviewing Appendix A, it appears that over a period of 15 years, out of nine decisions in cases brought by the NZCC (which, as a plaintiff, has an advantage in expertise and investigation resources):

- the NZCC had two wins and two losses (and in *Data Tails*[4] achieved the highest penalty ever awarded under the Commerce Act);
- three cases were interlocutory, so applied only a *prima facie* case standard; and
- in the final two cases, the NZCC failed to establish jurisdiction:
    - In one of those, *BOPE*, it failed to establish the market in which it said the contravention occurred, which was equally fatal to its substantial lessening of competition case as it was to its misuse of market power argument.
    - To that list the Ministry might also add *AstraZeneca*, an investigation into an allegation of tying in breach of s36, where the Supreme Court (2009) similarly found the NZCC had no jurisdiction.

Equally, in each of the three recent investigations closed by the NZCC with no action, (*Sky,*[5] *Progressive,*[6] and *Winstone*[7]) the published reports demonstrate the NZCC's findings did not differ as between s27 and s36, which suggests that had a substantial lessening of

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[4] *Commerce Commission v Telecom Corporation of New Zealand Ltd*, High Court, Auckland, 9/10/2009, CIV-2004-404-133; *Telecom Corporation of New Zealand Ltd v Commerce Commission* [2012] NZCA 278, (collectively, "***Data Tails***").

[5] Commerce Commission *Investigation report on Sky TV contracts* (8 October 2013).

[6] Commerce Commission *Progressive Enterprises Limited: investigation closure report* (20 November 2014).

[7] Commerce Commission *Investigation into Winstone Wallboards Limited* (22 December 2014).

competition test been applied, equally no action would have been taken.

(f) The Ministry's analysis shows at best, in theory, two decisions (*Carter Holt Harvey Limited*[8] and *0867*) might have gone the other way, had a substantial lessening of competition test been applied as opposed to a taking advantage test. However, there has been no rigorous analysis of that question and, in our view, based on the cases as reported, it seems highly unlikely either would have been decided differently. Nor is two successful cases in 15 years out of line with international enforcement, when New Zealand's size of market is taken into account. In the United States, both investigations and proceedings under s2 of the Sherman Act (the equivalent to s36 of the Commerce Act) make up a very small portion of antitrust investigations and proceedings.[9] Indeed, in the US, a country with a population 70 times greater than New Zealand's, from 2005 to 2014, the US Department of Justice ("**DOJ**") has only filed one District Court proceeding relating to s2 of the Sherman Act

(g) An examination of past enforcement shows that since *Port Nelson*[10] there have been limited cases[11] where there has been a breach of s27. Given the scarcity of pure s27 cases since *Port Nelson*, it is difficult to see how importing the SLC test into the misuse of market power prohibition would give rise to more frequent enforcement of s36.

(h) In our submission, when weighed against the regulatory uncertainty and other commercial costs of legislative reform of a law, which the Ministry identifies is currently relatively comprehensible for businesses to administer, a significantly more compelling case for reform is required before the Ministry should act to amend the law. This is particularly important for a country the size of New Zealand that, by necessity, has a number of markets with one or two large businesses (a number of which are Crown-owned businesses).

(i) We do not exclude the possibility that consistency with Australian law could provide that justification, given the large number of integrated trans-Tasman businesses operating in New Zealand and the problems the courts would likely encounter with a lack of new case law precedent, if Australia were to amend its provisions.[12]

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[8] *Commerce Commission v Carter Holt Harvey Building Products Ltd* (2000) 9 TCLR 535; *Carter Holt Harvey Building Products Ltd v Commerce Commission* (2001) 10 TCLR 247; *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* [2004] UKPC 37, (collectively "***Carter Holt Harvey Limited***").

[9] See US Dept. of Justice *Antitrust Division Workload Statistics FY 2005-2004*. In 2013, 25 investigations related to s1 of the Sherman Act (the equivalent to s27 of the Commerce Act) while 2 related to s2. In 2014, no investigations related to s2 of the Sherman Act, while 31 related to s1. In both 2012 and 2013, 3 District Court proceedings were filed in relation to s1 of the Sherman Act, while no District Court proceedings were filed in relation to s2 of the Sherman Act. .

[10] *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762; *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554, (collectively "***Port Nelson***").

[11] For example, a breach of s 27, and not s 30, was found in *Commerce Commission v Opthalmological Society of New Zealand Inc* (2004) 10 TCLR 994.

[12] The Competition Policy Review Final Report, Part 4 (31 March 2015) (the "**Harper Review**") and the Government Response to the Competition Policy Review (24 November 2015).

Enforcement tools

(j) We support the Ministry's aim of ensuring greater simplicity in enforcement. In that context, the Ministry's proposed review of enforcement by the NZCC is appropriate.

(k) However, in conducting this review, we recommend that:

(i) careful consideration be given to the requirement for a credible case to be built before a court enforceable undertaking is sought from any potential defendant. We note the Fair Trading Act 1986 ("**Fair Trading Act**") effectively creates a strict liability regime and the prohibition is comparatively simple to apply, whereas significantly more complex factual considerations are involved in an analysis of Commerce Act breaches, particularly where a netting of pro and anticompetitive effects is required to establish breach (in considering the SLC prohibition), and expert evidence may also be useful to inform the position taken on both sides;

(ii) the imposition of any penalties should remain solely a matter for the courts;

(iii) any enforceable undertaking regime should include appropriate checks and balances on the NZCC's discretion - in particular given it has been recognised that proceedings under the Commerce Act are quasi-criminal in nature.[13] In this context, consideration may be given to creating a role of Hearings Officer (similar to the European Commission and UK Competition and Markets Authority) to assist in striking the balance between speed and natural justice in any court enforceable undertakings regime; and

(iv) careful consideration be given to creating a regime that enables settlements to be reached without requiring defendants to admit breaches of the Commerce Act. Both in New Zealand and overseas, the nature and scope of admissions are frequently a greater sticking point in settlement negotiations in competition law cases than the level of the penalty itself. Creating a settlement regime that did not require admissions of breach would likely significantly decrease the time and cost involved in reaching settlement agreements.

Market study powers

(l) The cost of market studies is high and is borne by all market participants. Overseas experience suggests that costs could well be in the order of hundreds of thousands of dollars (or more) for businesses that are required to respond to market studies. As such, it imposes a new common cost (like a tax) on all market participants, which is then naturally passed on to consumers. It is our view that this cost is too high in comparison to the potential benefit derived from

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13 See *Port Nelson Limited v Commerce Commission* [1994] 3 NZLR 435, 437 (CA), and *Commerce Commission v Roche Products (New Zealand) Ltd & Ors* (2003) 10 TCLR 688 at [57].

market studies. For this and other reasons we do not support the introduction of a market studies provision.

3. ABOUT RUSSELL MCVEAGH

3.1 Russell McVeagh is recognised as one of New Zealand's leading corporate law firms and its client base includes many of this country's largest businesses.

3.2 Russell McVeagh has a dedicated specialist competition team, the members of which frequently advise clients on the application of the Commerce Act as enforced by the NZCC. Russell McVeagh has advised local and foreign corporate clients on competition law matters, including on anticompetitive exclusionary conduct, and is familiar with the manner of operation of competition and antitrust law in other jurisdictions, including through solicitors in its team having practised in the EU, so is well placed to comment on the matters the Issues Paper seeks to address.

4. ANTICOMPETITIVE EXCLUSIONARY CONDUCT

Question 1 - Has the Ministry accurately described the type of conduct that countries typically seek to prohibit?

4.1 The Ministry has provided a good summary of the benefits of competition to the economy and of the competitive process. In particular, the Ministry has focussed on the dynamic and ruthless nature of competition. It is inherent in the type of competition that the law is seeking to foster that businesses will harm other competitors in the process of providing lower prices or better goods and services to consumers in winning, through improved offerings, a greater share of the market.

4.2 The Ministry has also appropriately captured the sentiment, which has been articulated repeatedly through the courts (originally from Judge Learned Hand in the US); that striving to acquire market power encourages innovation and firms should not be punished when they attain it, nor, having acquired market power, should they be prevented from innovating further. Consumers benefit from increased productivity and innovation. The Ministry in this context has also appropriately captured the point that it is not the purpose of the prohibition against market power to simply protect small businesses against competition from large businesses.

4.3 However, when articulating the purpose of the misuse of market power prohibition, the Ministry has failed to provide the context for that prohibition within the broader scheme of the Act. In particular, the misuse of market power prohibition is only one of a number of prohibitions against anticompetitive exclusionary conduct contained in the Commerce Act, which would not be evident on a reading of 2.1.2 of the Issues Paper.

4.4 In addition, the Ministry uses "effects test" to describe two separate effects, first an "exclusionary effect" and second, an "effect on competition in a market". The distinction between these two effects is significant in understanding the comparative analysis of prohibitions and defences available in other jurisdictions. While the Ministry's description of the law as applying in those other jurisdictions is accurate, again, the use of the term "effects test" confuses a proper analysis of the way in which New Zealand's law does and does not differ from those jurisdictions.

4.5 In summary, most developed competition law regimes have at least four key prohibitions that relate to the acquisition, or maintenance or use, of market power or the lessening of competition in a market. These are:

(a) Prohibition against agreements that substantially lessen competition in a market ("whole of market effect");

(b) Prohibitions against cartels (strict liability, defence available if a legitimate joint venture and neutral or pro-competitive whole of market effect);

(c) Misuse of market power ("exclusionary effect", often with legitimate business rationale/neutral or pro-competitive "whole of market effect" defence);

(d) Merger control prohibits business acquisitions that lessen competition in a market ("whole of market effect" test - authorities note an increase in market power equals a lessening of competition).

4.6 In this context, it is unsurprising that many of the investigations and proceedings brought under s36 include claims that the agreements entered into pursuant to the single firm conduct also had the effect of substantially lessening competition in a market. The concepts of use of market power and substantially lessening competition are inextricably entwined. As the NZCC used to say in its merger control decisions, they are two sides of the same coin.[14]

4.7 In that context, it is also unsurprising that when interpreting "taking advantage" the courts have resorted to considering what a workably competitive market would look like (necessarily a hypothetical analysis, because, in the real world market under consideration, one participant has market power so it is presumed that market is not workably competitive) and, in that context, considering how the behaviour and outcomes the NZCC is challenging as "anticompetitive" differ to those to be expected in a competitive market.

4.8 This is the counterfactual test for "taking advantage". This can be seen from extracts from the relevant case law, for example:

(a) The Privy Council stated:

> - ...if the terms Telecom were seeking to extract were no higher than those which a hypothetical firm would seek in a perfectly contestable market, Telecom was not using its dominant position.[15]
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> - ...**A dominant firm is as free to compete in the market as a firm that is non-dominant, so long as it does not act in an anticompetitive manner** by abusing its position of dominance. With this in view, the section is carefully worded. The word "use" requires that a causal relationship is shown between the conduct which is alleged against the dominant firm and its dominance or market power. ...
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> It follows that if a dominant firm is acting as a non-dominant firm otherwise in the same position would have acted in a market which was competitive it cannot be said to be using its dominance to achieve the purpose that is prohibited. That is the basis on which the counterfactual test is founded. ...**It would be surprising if Parliament intended to proscribe conduct by a company with sufficient resources to compete effectively. Something more than that is required.**[16]

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[14] NZCC *Decision No 456 - Shell New Zealand Limited v The Gas Company Limited* (1 March 2002) at [68].

[15] *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* (1994) 32 IPR 573 (Privy Council), at lines page 155, lines 7-9.

[16] *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* [2004] UKPC 37 at [51] and [52].

(b) The Supreme Court held:

- **If the impugned conduct has a business rationale, that is a factor pointing against any finding that conduct constitutes a taking advantage of market power**. If a firm with no substantial degree of market power would engage in certain conduct is a matter of commercial judgment, it would ordinarily follow that a firm with market power which engages in the same conduct is not taking advantage of its market power.[17]

- [Having considered the Australian authorities that, in the Commission's submission, adopted alternative formulations of the counterfactual test] **All the relevant reasoning involves, either expressly or implicitly, consideration of what the dominant firm would have done in a competitive market;** that is, in a market in which hypothetically it is not dominant. The essential point is that if the dominant firm would, as a matter of commercial judgement, have acted in the same way in a hypothetically competitive market, it cannot logically be said that its dominance has given it the advantage that is implied in the concepts of using or taking advantage of dominance or a substantial degree of market power.[18]

- **The comparative exercise is designed to pose and answer the question whether the presence of competition in the hypothetical market would have restrained the alleged contravener from acting in that market in the same way as it acted in the actual market**. If the answer is yes, the alleged contravener has taken advantage of its market power. **If the answer is no**, it has not done so, because **the presence of that power gave it no material advantage**.[19]

- **A firm has market power when it is not constrained in the way in which it would be constrained in a competitive market.** Any firm that is substantially unconstrained by competitive pressures has substantial market power. Market power gives some advantage if it makes easier - that is, materially facilitates - the conduct in issue. **The question whether dominance or substantial market power exists implies a comparison between the position of the firm in the actual market and a firm in the same general circumstances but otherwise in a workably competitive market. The contrast inherent in the concepts of dominance as substantial degree of market power is the contrast between the actual market and a hypothetically competitive market.** That same contrast is inherent in the inquiry into whether market power has been "used" within the meaning of s 36.[20]

- The Commission's argument, that on any rational consideration the potential loss of customers would necessarily and inevitably have outweighed the other matters at issue, relies on speculation rather than evidence.[21]

- The Commission failed to show that in a hypothetical workably competitive market, because of fear of losing retail customers, company X would not have introduced an 0867 service. What the foregoing analysis demonstrates is that, questions of additional revenue aside, the advent of dial-up internet had made the termination charges regime under the 1996 ICA unsustainable for a firm on the

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[17] *Commerce Commission v Telecom Corporation of New Zealand Limited* [2010] NZSC 111 at [26], citing *Boral Besser Masonry Ltd v Australian Competition and Consumer Commission* [2003] HCA 5, (2003) 215 CLR 374 at [170].

[18] *Commerce Commission v Telecom Corporation of New Zealand Limited* [2010] NZSC 111 at [31].

[19] *Commerce Commission v Telecom Corporation of New Zealand Limited* [2010] NZSC 111 at [32].

[20] *Commerce Commission v Telecom Corporation of New Zealand Limited* [2010] NZSC 111 at [33].

[21] *Commerce Commission v Telecom Corporation of New Zealand Limited* [2010] NZSC 111 at [48].

> wrong side of the asymmetry. **Any firm acting competitively, whether dominant or not, would have taken steps to mitigate the loss by introducing a scheme analogous to the 0867 package rather than continue to incur substantial losses.** It has therefore not been proved that Telecom used its (assumed) dominant position in the relevant markets when introducing its 0867 service.[22]

4.9 The above extracts from the Supreme Court decision in *0867* demonstrate:

(a) The Supreme Court (like the Privy Council before it) also clearly articulates why any rule that only catches businesses that have market power must also require a causal connection between the market power and the conduct at issue or otherwise risk deterring big businesses from competing effectively.

(b) As the Supreme Court points out, a market with a business with market power in it is not a workably competitive market, the presence of market power denies that market of effective competition. Therefore, any analysis of whether the business is competing "on the merits," as one expects it to do in a workably competitive market, must postulate that workably competitive market to consider that question.

(c) The Supreme Court had no difficulty applying the counterfactual analysis (the decision was a mere 50 paragraphs long). The NZCC of course did not agree with its conclusions, but each of the High Court, Court of Appeal and Supreme Court, on a careful analysis of the facts, did not characterise Telecom's actions as anything other than competition on the merits, which did not rely on its market power.

(d) The Supreme Court's consideration of the taking advantage limb, involved an analysis of legitimate commercial practices, which would appear to also be neutral or pro-competitive on a net efficiency standard if analysed under the substantial lessening of competition test. To that extent, it is not materially dissimilar to the legitimate business rationale defence as applied in the US.

4.10 Accordingly, in our submission it is important the Ministry clearly understands the interrelationship between the concepts of "market power", "workably competitive markets" and "substantial lessening of competition" in order to properly consider both whether the extent of enforcement has been sufficient, and whether any modifications to the prohibition are appropriate.

Question 2 - Has the Ministry accurately described the different approaches countries take in their rules against anti-competitive exclusionary conduct?

4.11 The Ministry has done a careful and thorough analysis of the applicable laws relating to misuse of market power in other relevant jurisdictions. We include below some minor refinements to Tables 1 and 2 included in the Ministry's Issues Paper, some of which merely capture the Ministry's commentary in the table format, and some of which are our additions to improve the accuracy of the picture presented in those Tables.

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[22] *Commerce Commission v Telecom Corporation of New Zealand Limited* [2010] NZSC 111 at [49].

Table 1: Persons who are subject to the rule

	NZ	Australia	Harper (not adopted)	EU	USA		Canada
Persons who are subject to the rule	Persons with a **substantial degree of market power**	Corporations with a **substantial degree of market power**	Corporations with a **substantial degree of market power**	Undertakings with a **dominant position** **This includes independent single firms and multiple firms having collective market power**	Persons with **monopoly power**	Persons with a **dangerous probability of achieving monopoly power**	One or more persons with **substantial or complete control** of a class of business
Single firm conduct or collective dominance ?	**Single firm**	**Single firm**	**Single Firm**	**Collective dominance**	**Single Firm**	**Single Firm**	**Joint dominance**

Table 2: Conduct that breaches the market power prohibition

	NZ	Australia	Harper (not adopted)	EU	USA		Canada
Purpose versus effect	The **purpose** of their conduct is to limit competitors' ability to compete ~~exclude competitors from the market~~ Purpose can be inferred from effect	The **purpose** of their conduct is to limit competitors' ability to compete ~~exclude competitors from the market~~ Purpose can be inferred from effect	The **purpose, effect** or **likely effect** of their conduct is to substantially lessen competition	The **effect** of their conduct is to hinder the maintenance or development of the level of competition in the market	The **effect** of their conduct is to impair the opportunities of rivals		They undertake an "anti-competitive act", and the **effect** of their conduct is to prevent or substantially lessen competition
Causal connection	They **take advantage** of their market power	They **take advantage** of their market power	N/A	Not settled	The conduct **contributes to the maintenance** or enhancement of the monopoly power	The conduct **contributes to the acquisition** of the monopoly power	N/A
Defences	**N/A**	**N/A**	**Removed defence in Final Report,[23] but suggested legislative guidance to assist courts.**	**Efficiency or legitimate business rationale**	**Efficiency or legitimate business rationale**		**N/A**

[23] Harper Review (Part 4) at p 342 - 344. "The defence provided that the prohibition would not apply if the conduct in question would be both:

- a rational business decision by a corporation that did not have a substantial degree of power in the market; and
- likely to have the effect of advancing the long-term interests of consumers."

However, this defence was not supported by submissions.

4.12 The key point to emphasise, as the Ministry noted, is that the distinction between a purpose test and an (exclusionary) effect test should not be overstated. We agree with that proposition. Our experience, in practice, is that the purpose of the dominant entity to exclude its competitors is invariably not contested.

4.13 As the Privy Council said in *Telecom v Clear*:

> - If a person has used his dominant position it is hard to imagine a case in which he would have done so otherwise than for the purpose of producing an anticompetitive effect; there will be no need to use the dominant position in the process of ordinary competition. Therefore**, it will frequently be legitimate for a Court to infer from the defendant's use of his dominant position that his purpose was to produce the effect in fact produced.** Therefore, as the Court of Appeal in the present case accepted, use and purpose, though separate requirements, will not be easily separated.
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> ...
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> Although it is legitimate to infer "purpose" from use of a dominant position producing an anticompetitive effect, **it may be dangerous to argue the converse ie that because the anticompetitive purpose was present, therefore there was use of a dominant position**. ...It is unavoidable that, as a competitor, Telecom will be seeking in one sense to "deter" Clear from competing successfully. A monopolist is entitled, like everyone else, to compete with its competitors; if it is not permitted to do so it "would be holding an umbrella over inefficient competitors".[24]

4.14 Parliament has confirmed that purpose may be inferred objectively, ie from effect, in s36B.

4.15 Finally, as noted in our opening comments above, allegations of misuse of market power are regularly coupled with allegations that the resulting agreements substantially lessen competition in a market. A finding of one generally also involves a finding of the other; for example, in *Port Nelson*, and in the NZCC's recent investigation into Sky TV, where it found the agreements were likely to give rise to a substantial lessening of competition and likely to breach s36. However, for other reasons the NZCC chose not to take any action in respect of Sky TV.

Question 3 - Has the Ministry accurately described the main elements of New Zealand's rule against anti-competitive exclusionary conduct?

4.16 We agree in part with the Ministry's articulation at 2.3.1 of the market situation that indicates a participant has a substantial degree of market power, which is that the party with market power has an ability to raise prices above efficient costs (or reduce the quality of its product or service to an equivalent extent) without existing or potential competitors taking away sufficient customers over time to render unprofitable that increase in price/reduction in quality. Market power in buying markets is measured in the same way, but the converse (an ability to lower price without losing sufficient sellers to make the reduction in price unprofitable).

4.17 We do not agree that conduct such as refusing to supply or dictating non-price terms of supply assists in any way in establishing whether market power exists; rather, that is the type of conduct that may be alleged to misuse market power. It is important to keep the

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[24] *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* (1994) 32 IPR 573 (Privy Council), at lines 402.

concepts of the existence of market power and the conduct by the entity with market power separate.

4.18 We do agree, however, that the US permits action to be taken against a person that does not have market power at the time it engages in the conduct in question if the conduct would give rise to market power. In New Zealand (and Australia), in order for the NZCC to take action, it must be established the entity has market power at the time it took the action the NZCC alleges was anticompetitive.

4.19 We also agree generally with the Ministry's articulation of the test for taking advantage of market power, with emphasis on the quotes cited above. We agree that the taking advantage test is focussed on distinguishing competition on the merits with competition that actually harms the competitive process.

4.20 We agree with the description of the *Carter Holt Harvey* case study at page 22 in paragraph 2.3.2.1, but would add that the Court also found the low pricing by INZCO was an interim measure to continue to sell stock while the product was being redesigned, so there was a question as to whether the promotion had a sufficiently permanent effect for there to be a substantial lessening of competition arising from the behaviour over the length of timeframe usually assessed by the NZCC.

4.21 Finally, as noted at 4.12 above, we agree with the Ministry's statement in the body of the Issues Paper (although not reflected in the summary or conclusions) that the difference between a purpose test and an effects-test should not be overemphasised. It is important to recognise that in its present form s36 extends to catch anticompetitive effect through the inferring of purpose from effect (as acknowledged in the Issues Paper at 2.3.2.2).

Question 4 - In your opinion, what justifications can there be for requiring that a firm with a substantial degree of market power "take advantage" of that power?

4.22 We refer to our comments and relevant court citations at paragraph 4.8 above. Put simply, the "taking advantage" limb is an appropriate filter for distinguishing between competition "on the merits" and unfair or "anticompetitive" competition by big players. In this sense, it acts as a proxy for assessing whether the conduct was likely to be of a kind that has a negative effect on competition in the market.[25]

4.23 In New Zealand (as in Australia), the "taking advantage" requirement creates the causal link between the possession of market power and anticompetitive conduct. It prevents large or powerful firms from being held liable for breaches of competition law merely because of their size or power.

4.24 This causal connection is a critical element of the misuse of market power prohibition. This is because there is no "taking advantage" of market power if firms are "competing on the merits".[26] In the absence of this causal connection, a firm with market power could be held in breach of s36 by introducing a new product that is so innovative and attractive to customers that it puts its competitors out of business (for example, the impact of smart phones on dumb phone manufacturers), when that type of innovation is what the Commerce Act is intended to achieve.

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[25] Caroline Coops (Partner, King & Wood Mallesons), Commentator on *"An Economist's Take on Taking Advantage" Is 'taking advantage' a uniquely Australian concept and should it be retained* (12-14 September 2014) Competition and Consumer Committee Annual Workshop.

[26] *Telecom Corp of NZ Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 (Privy Council) at p 402: "If a person has used his dominant position it is hard to imagine a case in which he would have done so otherwise than for the purpose of producing an anti-competitive effect: there will be no need to use the dominant position in the process of ordinary competition."

4.25 The "taking advantage" requirement is not misaligned with the other prohibitions in the Commerce Act or the equivalent prohibitions overseas - it creates the necessary causal connection between having market power (ie being big) and the exclusionary outcome (ie acting with the purpose of preventing or deterring competition):

(a) Sections 27 and 47 similarly require a causal connection between a triggering cause (in those provisions either a contract, arrangement or understanding or a business acquisition) and the "effect on market".

(b) The efficiency/business rationale defences in the EU and US are a proxy for the "taking advantage" requirement - ie if there is a legitimate business rationale then the market power itself is not the cause of any "exclusionary effect".

4.26 Removing the "taking advantage" requirement would make s36 the outlier.

4.27 As the Ministry is aware, since the Harper Review was released, its recommendation that the "take advantage" test be removed was met with criticism from academics and practitioners on the basis that its removal would mean the prohibition would not provide for a clear causative link between substantial market power and the anticompetitive conduct. The Australian Government has ultimately not adopted this recommendation, opting instead to consult further on the misuse of market power provision.[27]

4.28 To prohibit firms with market power from engaging in conduct with the purpose (or effect) of damaging competitors, without requiring proof that such conduct is linked to that market power or would not occur in a competitive market, would result in firms with large market shares being conservative when competing. Russell McVeagh team members who have practised in the European Union have seen that effect first-hand. It is, in our submission, not the right balance for New Zealand. It would be detrimental to consumers (who benefit from highly competitive markets) and would be a poor policy outcome in a small economy like New Zealand's, which benefits from the efficiencies that can be attained from larger scale businesses.

4.29 We also note that the NZCC's key purported problems with the existing "taking advantage" requirement is that it is too difficult to define "a hypothetical firm which does not possess a substantial degree of market power, but which is otherwise in the same circumstances as the dominant firm in question."[28] Moving to a so-called "effects-based" test (with no "taking advantage" requirement) would not resolve this issue given it would still require a counterfactual analysis comparing the degree of competition in the market with the challenged conduct against the degree of competition in a hypothetical market without the challenged conduct. As noted by the US Department of Justice's 2008 report on *Single-Firm Conduct Under Section 2 of the Sherman Act*:[29]

> The effects-balancing test confronts a court with the administrative challenge of conducting an open-ended measuring of effects that includes comparing the existing world with a hypothetical world that is subject to debate. These administrability problems include limitations on both the ability of economists accurately to measure the net consumer-welfare effects of particular conduct and the ability of judges and juries to evaluate this evidence.

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[27] Treasury Media Release (24 November 2015), linked here. Comments on this discussion paper will be due by 12 February and the Treasurer, Hon. Scott Morrison, will submit a proposal for Cabinet consideration in response to this issue by the end of March, at which time the Australian Government will announce a final position.

[28] See for example: Dr Mark Berry. Chair of the NZCC. (22 February 2011). *The New Zealand Approach to Monopolisation, Mergers and Cartels*. An Address to the Taiwan Fair Trade Commission.

[29] US Department of Justice. (2008). Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act at page 37.

4.30 In fact, the hypothetical counterfactual analysis required for a so-called "effects-based" s36 would likely be significantly more difficult to apply than the existing s36 prohibition given it would require the Court to consider both:

(a) the degree of competition in the market in both the actual and hypothetical scenarios; and

(b) the extent to which any lack of competition in the actual and hypothetical market is caused not by the conduct in question but simply by the existence of the firm's market power. Given the existence of market power necessarily means that the market would already lack workably effective competition that would be a complex analysis.

4.31 Therefore, it is Russell McVeagh's view that the "take advantage" requirement in s36 ought to be retained.

Question 5 - What justification can there be for a purpose-based (rather than effects-based) approach? Why do you think Australia adopted such an approach with its Trade Practices Act 1974?

4.32 For the reasons set out above, we do not experience, in practice, the New Zealand provision as a "purpose based" test. The question is predicated on a dichotomy that does not exist in practice.

4.33 The genesis of the purpose limb appears to be the translation of US law into the Australian Trade Practices Act. General Gordon Freeth in the Commonwealth Parliamentary Debates of 6 December 1962, when introducing the new prohibition, has been cited by Houston Kemp as saying:[30]

> "Monopolization will be defined, broadly speaking, as acquiring or using monopoly power with the intention of preventing a person from entering or expanding a business, or in a manner that is unreasonable and detrimental to consumers of goods or services."

4.34 As noted by Caroline Coops, commenting on that Houston Kemp paper:[31]

> The existence of monopoly power alone is insufficient - anti-competitive conduct or 'wilfulness' must also be established. The defendant must have obtained or maintained its monopoly (or market power) through exclusionary or predatory means (as opposed to through "growth or development or as a consequence of a superior product, business acumen or historic accident")...

Question 6 - Does section 36(1) make sense, given that authorisations do not apply to section 36(2)?

4.35 We see no issue with s36(1).

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[30] Greg Houston and Jennifer Fish, *An Economist's Take on Taking Advantage,* (12 - 14 September 2014) Law Council of Australia, Business Law Section Competition and Consumer Workshop at p 2.

[31] Caroline Coops (Partner, King & Wood Mallesons), Commentator on *"An Economist's Take on Taking Advantage" Is 'taking advantage' a uniquely Australian concept and should it be retained* (12-14 September 2014) Competition and Consumer Committee Annual Workshop. As noted in that paper, in the US, the "pro-competitive justification" then effectively rebuts any anti-competitive intent, and, the effect of conduct on a market is taken into account in the more traditional rule of reason analysis, which does not necessarily involve a counterfactual assessment.

Question 7 - Has the Ministry identified the right criteria for assessing the adequacy of section 36 of the Commerce Act? Should any criteria identified be excluded, or should criteria not mentioned be added?

Additional criteria to be considered

4.36 It is Russell McVeagh's view that the following additional criteria ought to be included when assessing the adequacy of s36 (although both relate primarily to the manner in which a substantial degree of market power should be assessed as a threshold matter for the application for s36, rather than the "exclusionary purpose" or "taking advantage" limbs):

(a) **The need for New Zealand firms to gain economies of scale to be able to compete internationally and/or to offer competitive prices to New Zealand consumers.** Because of the comparatively small size of New Zealand markets, businesses need to be of a reasonable size in order to gain the efficiencies required to enable them to compete internationally and/or to offer efficient competitive prices to New Zealand consumers.

(b) **Consideration of New Zealand's small and remote economy, and the relatively small size of New Zealand markets**. This was discussed at paragraph 2.4.3.2 of the Issues Paper, but we suggest the relatively small size of the New Zealand consumer base also be considered as a relevant criterion. In particular, careful consideration should be given to the fact that a country the size of New Zealand will, by necessity, have a number of markets with only one or two large businesses (a number of which are Crown-owned businesses). Accordingly, any changes to s36 will potentially impact a large number of businesses across New Zealand's economy.

Question 8 - Should the criteria used be given equal weight?

4.37 Broadly, they should be given equal weight, although we would:

(a) accord a higher priority to at least some degree of consistency with Australian law;

(b) give priority to predictability from the perspective of the party to whom the law would apply; and

(c) caveat the desire for simplicity with the recognition that the flexible application of the law to numerous different markets will necessarily mean that predictability of outcome may not be achievable (recognising it is also not achieved elsewhere in the world either, except where rules operate to require large firms to pull their competitive punches).

Question 9 - Do you agree that section 36 may not effectively assure the long-term benefit of consumers? If you agree, are there any sectors of the economy where you consider this to be well illustrated? If you disagree, please explain why.

4.38 No, we do not agree there is a problem with the formulation of the s36 test.

4.39 As considered further in the discussion below, it is possible, or likely, that there has been under-enforcement of this section by the NZCC over the past 8 years since *0867* was decided. Views may differ as to the reasons for that.

4.40 In Box 1 (below) we capture some recent independent commentary from Global Competition Review on the topic when undertaking its survey of enforcement by various competition authorities internationally.

4.41 It is possible that some of the enforcement tools under consideration by the Ministry in this current review may assist to remedy the perception of under-enforcement.

Box 1- GCR Rating Enforcement Survey 2015 - New Zealand Section[32]

Observers in New Zealand say that in 2014, the Commerce Commission again preferred to hang its hat on cartel enforcement to the detriment of single-firm conduct cases, even though the cartels it tackles are relatively small-scale endeavours. The misuse of market power provision is interpreted very narrowly in courts, which undeniably makes litigation difficult for the commission. Still, lawyers disapprove of its willingness to quickly surrender instead of pursuing cases where dominance harms the public.

The numbers confirm the lack of activity. Only one abuse of dominance investigation began in 2014, and of the three cases that were closed, none resulted in behavioural remedies or monetary fines. The Winstone plasterboard investigation made national headlines because the commission announced it could find no evidence of anti-competitive behaviour despite its more than 90 per cent share of the market, its ability to fend off well-resourced market entrants and the widespread allegations of increasing prices.

Question 10 - Is it fair to say that businesses will generally know if they are acting in a way that they would not in a competitive market - i.e. that the current test is sufficiently predictable?

4.42 Yes, in our experience this is correct as a general proposition. It is relatively straightforward for firms to assess whether they would pursue a certain course of conduct if they did not have market power.

Question 11 - Do you agree that section 36 - as applied by the courts - is too complex to ensure that it is cost-effective and timely?

4.43 No, it is our view that s36 is not too complex for the courts (or for that matter, for the NZCC) to apply. It is our view that legal application of s36 is relatively simple, and that any complexity stems from the factually complex nature of competition law disputes. This factual complexity will remain a characteristic of s36 claims regardless of how the section is formulated (and could potentially be exacerbated if it is changed to a so-called "effects-based" test - see 4.29 and 4.30 above).

4.44 The most difficult factual issues tend to arise in the interface between regulation and positing a workably competitive market, where it is in part regulation that drives the behaviour, as it was in *0867*. However, ultimately those issues can be resolved on the facts with the assistance of expert economists and counsel.

Question 12 - Do you agree that section 36— as applied by the courts — is not well aligned with other relevant provisions?

4.45 As set out above, we would not agree with that proposition.

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[32] Global Competition Review *Ratings Enforcement 2015* (18 June 2015), available online here: http://globalcompetitionreview.com/surveys/article/38903/illegal-profits-bank-shenanigans-tipline-12-january-2016.

4.46 We can see that the word "purpose" could be replaced in s36(2) with "likely effect" without changing very much in the application of the section, due to the way in which the term "purpose" has been interpreted by the courts.

4.47 If, however, the word "purpose" were replaced with "purpose, effect or likely effect", that would create significantly more material issues in the application of the section. That is because the effect of an act is not necessarily only determined at the time it is undertaken, so such an amendment would likely lead to businesses being liable for unforeseen and unforeseeable consequences of their actions. As noted by the US Department of Justice's 2008 report on *Single-Firm Conduct Under Section 2 of the Sherman Act*:[33]

> critics note that the complexity of administering the effects-balancing test would make it difficult for firms to determine at the outset whether specific conduct would violate section 2, thereby potentially chilling procompetitive conduct and reducing consumer welfare. Moreover, a legal rule under which every action of a monopolist must be scrutinized for net consumer-welfare effects threatens to chill a monopolist's incentives to engage in procompetitive conduct out of fear of antitrust investigation, litigation, or even mistaken liability—again, potentially harming consumer welfare.
>
> ...
>
> ("[W]hile a general balancing test is flexible . . . it is inherently lacking in any objective content that businesses can apply in a predictable manner to make their decisions." ... a "static market-wide balancing test" would "place a costly and often impossible burden on the defendant when deciding in real time how to conduct its business"

4.48 "Likely effect" is established at a single point in time, when the action is undertaken and "likely" incorporates already the concept of forseeability.

4.49 As noted above in our submission, the concept of "taking advantage," as interpreted by the courts, already sufficiently incorporates a proxy for a "whole of market effect" consideration in its requirement that the behaviour have a legitimate business rationale (ie if it is the type of conduct undertaken in a competitive market then it is presumptively neutral or pro-competitive).

Question 13 - Given your view on the correct implication of having a small and remote economy, do you consider that section 36 appropriately reflects that implication?

4.50 Yes, it is Russell McVeagh's view that s36 appropriately reflects the small and remote nature of New Zealand's economy. As discussed above at paragraph 4.2 and 4.36, it is particularly important that competition law relating to unilateral conduct does not stifle business innovation, development and competition. Such a result would negatively impact New Zealand's economy and consumers.

Question 14 - For each of the criteria it has adopted, has the Ministry's assessment been well-reasoned?

4.51 We do not disagree with the analysis, other than to note that the proposition that s36 has not been adequately enforced by the Courts is not supported on the analysis of the case law or any other analysis apparent on the face of the Issues Paper (although as noted at paragraph 4.39 it is possible, or likely, that there has been under-enforcement of this section by the NZCC over the past 8 years, which has resulted in a lack of recent cases before the Courts).

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[33] US Department of Justice. (2008). Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act at page 38.

Question 15 - If you are submitting that the criteria for assessment should be different from those used by the Ministry, how might the assessment be different using your preferred criteria?

4.52 It is Russell McVeagh's view that weight ought to be given to encouraging business growth, and particularly to recognising that increased scale can result in greater efficiencies for business, which, in turn, benefits consumers.

Question 16 - Do you agree with the Ministry's conclusion? Please explain why.

4.53 No. It is Russell McVeagh's view that s36 has acted as an adequately effective prohibition on anticompetitive single firm conduct, especially since its amendment in 2001. In particular, and in response to the Ministry's conclusions at paragraph 2.6 of the Issues Paper:

(a) Section 36, in and of itself, has not failed to punish anticompetitive conduct. Section 36 has been used to punish anticompetitive conduct through litigation and also through other enforcement responses, such as through NZCC investigation. In fact, under s36, the NZCC has achieved its highest ever penalties under the Commerce Act.

(b) As discussed in more detail in our response to Questions 10 and 11, s36 is not too complex to allow for cost-effective and timely application. Based on our experience, it is not the legal framework of s36 that causes complexity or delay - it is the factually complex and highly fact-specific nature of single-firm conduct claims that causes delay. This will remain the case regardless of how s36 is formulated (and could potentially be exacerbated if it is changed to a so-called "effects-based" test - see 4.29 and 4.30 above). Proceedings involving a claim under the Commerce Act will require substantial factual analysis (often including economist reports on competitive dynamics in the relevant industries and markets). This will result in some cost and delay, but this has more to do with the factually complex nature of competition law disputes than it does with the formulation of s36 - the same is also true of cases under s27. Overseas jurisdictions, such as the US and Europe, that have differently drafted single-firm conduct prohibitions similarly find that single-firm conduct litigation is lengthy and factually complex.

(c) As discussed in response to Question 12, it is our view that s36 is not misaligned with other prohibitions in the Commerce Act (such as ss27 and 47).

Question 17 - Do you have any other comments you wish to make about the Ministry's approach to assessing the current law on anti-competitive exclusionary conduct?

4.54 We repeat, for completeness, that any analysis of the effectiveness of s36, if coupled with a call to introduce a substantial lessening of competition test into that section, must include an analysis of the enforcement track record of s27 (in isolation from s30), as s27 already catches agreements that substantially lessen competition in a market.

4.55 That analysis will inform the appropriate counterfactual for the proposed change to s36 - ie if a substantial lessening of competition test applied, would it increase levels of enforcement? Or are other drivers, such as the complexity of establishing anticompetitive effects and the delays inherent in the court processes of this nature, that are the main drivers of the lack of recent enforcement action?

Question 18 - Which of the potential options identified would you like to see discussed if the Ministry publishes an options paper next year? Please explain why these options would be worthy of consideration.

4.56 The first option mentioned at paragraph 2.7 of the Issues Paper (maintenance of the status quo and insertion of "guidance" into the Commerce Act) is worthy of consideration.

Question 19 - Which of the potential options identified are not worthy of discussion if the Ministry publishes an options paper next year? Please explain why these options would not be worthy of consideration.

4.57 Removal of the "taking advantage" provision in s36 should not be considered. As discussed above in response to Question 4, this is a crucial element of the prohibition on misuse of market power. Without that causal connection, there is no proper justification to impose a different standard on parties with market power than those who do not have market power - otherwise it simply chills competitive behaviour by large businesses.

Question 20 - Are there any other potential options that the Ministry should consider?

4.58 We recommend a study of enforcement action taken under s27 (where no parallel claim is made of breach of s30) be undertaken.

Question 21 - In the event that an options paper is issued, what criteria should the Ministry use to assess the options the paper includes? In principle, should they be the same as whatever criteria are finally used to assess the adequacy of the New Zealand regime?

4.59 The criteria should be the same as the criteria used to assess the adequacy of the New Zealand regime, and should include the criteria mentioned above in response to Question 7.

5. ALTERNATIVE ENFORCEMENT MECHANISMS

Question 22 - Do you agree that standard enforcement of the Commerce Act (litigation by the NZCC in the courts) faces high costs and long delays? Please give reasons for your view.

5.1 Yes. Russell McVeagh's competition team has had extensive experience in assisting businesses with responding to, and seeking, enforcement under the Commerce Act. It is our experience that enforcement is often lengthy and expensive in respect of all aspects of the Commerce Act (including ss27, 30 and 36). Accordingly, there are real problems for the NZCC and for private parties in achieving effective enforcement in a timely and cost efficient way, so this review is appropriate.

Question 23 - Has the Ministry accurately identified the main types of alternative enforcement mechanism that a given country can adopt? If not, please explain why.

5.2 Broadly, yes.

Question 24 - Has the Ministry accurately described the main elements of New Zealand's alternative enforcement mechanisms? If not, please explain why.

5.3 Yes, it has.

Question 25 - Has the Ministry identified the right criteria for assessing the adequacy of alternative enforcement mechanisms under the Commerce Act? Should any criteria identified be excluded, or should criteria not mentioned be added?

5.4 No, additional criteria should be included.

Additional criteria to be included

5.5 It is Russell McVeagh's view that the following additional criteria ought to be included when assessing the adequacy of alternative enforcement mechanisms:

(a) **Procedural fairness.** Consideration ought to be given to the need to have procedural fairness in any alternative enforcement process. In particular, rules relating to evidence, privilege and standing ought to be considered as necessary criteria of any alternative enforcement mechanism. This is particularly important given it has been recognised that proceedings under the Commerce Act are quasi-criminal in nature[34] and there is potential for significant (multi-million dollar) penalties.

(b) **Specific right of appeal / review.** Alternative enforcement mechanisms ought to provide parties with a right of appeal from, or review of, a determination.

(c) **Scope of NZCC power.** It is important that an alternative enforcement mechanism (especially any enforceable undertaking regime, or any adjudication regime) include appropriate checks and balances on the NZCC's power to impose quasi-criminal penalty-like sanctions on defendants. Such checks and balances should be additional to standard appeal rights (as standard appeal rights can be costly to exercise in practice).

(d) **Complexity of Commerce Act allegations.** While simplicity is a desirable aim, it is important to recognise that allegations under the Commerce Act are typically factually complex, resting on complex arguments about closeness of competition, costs of supply and appropriate State limits on freedom to contract. Responding to and assessing such allegations often requires substantial economic analysis. If alternative enforcement mechanisms fail to recognise the complexity intrinsic in Commerce Act disputes, this may result in what the Ministry refers to as "false positive" or "type 1" outcomes, which would interrupt conduct that is not actually a risk to the long-term benefit of consumers.

(e) **Impact of admissions**: Careful consideration should be given to the role that needing to admit breaches of the Commerce Act currently play in settlement negotiations. Both in New Zealand and overseas, the nature and scope of admissions are frequently a greater sticking point in settlement negotiations in competition law cases than the level of the penalty itself. Creating a settlement regime that did not require admissions of breach would likely significantly decrease the time and cost involved in reaching settlement agreements.

Question 26 - For the criteria that the Ministry has included, have they been accurately described? If not, please explain why.

5.6 Yes.

Question 27 - Do you agree that the current settlements regime has a number of weaknesses? Please give reasons for your answer.

5.7 Broadly, yes.

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[34] See *Port Nelson Limited v Commerce Commission* [1994] 3 NZLR 435, 437 (CA), and *Commerce Commission v Roche Products (New Zealand) Ltd & Ors* (2003) 10 TCLR 688 at [57].

5.8 The current settlements regime would be enhanced if there was a mandatory requirement for the NZCC to provide investigated parties with full details of the NZCC's case (and evidence) against it before proceedings are filed by the NZCC. The NZCC's recently published guidelines recognise the importance of providing investigated parties with information about the complaints and concerns the NZCC is investigating.[35] But greater disclosure is required if parties are meaningfully able to engage in settlement discussions at a sufficiently early stage for settlement to be an efficient mechanism. A statement of the NZCC's case and the evidence, similar to the Statement of Objections prepared by the European Commission, provided confidentially to the investigated party(ies) reasonably in advance of any proceedings being commenced would address this issue.

5.9 Furthermore, in relation to the settlements regime, it is important to recognise that the agreement to settle is often only achieved because of the more limited (and less negative) publicity the settlement is likely to generate, and the ability to negotiate admissions. The greater the level of publicity and published material arising from the settlement, the less likely it is that the settlement will occur at all, and any failed settlement represents a missed opportunity for the NZCC to apply those saved resources (people, budget etc) to pursuing other potential infringements. Similarly, the requirement of defendants to admit breaches of the Commerce Act is often a significant sticking point in settlement negotiations (see 5.5 above). Removing that requirement would also likely significantly decrease the time and cost involved in reaching settlement agreements.

Question 28 - Do you agree that the cease and desist regime has proven ineffective? Please give reasons for your answer.

5.10 Our view is that the cease and desist regime could have been more effectively used, although the issue is essentially now moot. In any event, we would agree that a court enforceable undertakings regime has the potential to be more effective to allow for the timely closure of market power investigations, with remedies, than the cease and desist regime.

Question 29 - Should the NZCC make more use of the cease and desist process? Please explain why / why not.

5.11 See response to Question 28.

Question 30 - Do you agree that the settlements regime has proven simple enough to be cost-effective and timely, and that it is adequately predictable? Please explain why / why not.

5.12 Subject to the comments made in response to Question 27, we do agree with that as a general proposition. At the same time, we note that in the case of misuse of market power investigations, there appear to be more limited settlement options, due to the nature of the allegations. No business would likely admit to misusing market power, so the only settlements available tend to be to amend or not enforce a contractual provision (also available as a settlement of a s27 investigation), but without admission of breach. Where the issue is a refusal to supply, or predatory pricing, or even tying, settlement is significantly more difficult, as the commercial consequences of changing the behaviour alleged to be in breach, tends to be much more significant as it may result in the larger business having to commence a commercial relationship with a competitor it does not want, or lose a very large proportion of its sales because it lifts its price, or it may lose a significant quantity of business in a tender because it is not able to bundle its product suite.

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[35] NZCC *Competition and Consumer Investigation Guidelines* (December 2015) at [79].

Question 31 - Do you agree that the cease and desist regime, if it were used, would be unlikely to be cost-effective, timely and predictable? Please explain why / why not.

5.13 The lack of use of the provision[36] makes this assessment very difficult to undertake.

Question 32 - Do you agree that the settlement regime and the cease and desist regime both adequately protect the rights of firms? Please explain why / why not.

5.14 Broadly, yes. Although there are clearly potential risks that the NZCC may threaten litigation to achieve a settlement without having built a sufficient case (knowing the reputational consequences to the defendant of that claim even being brought), in practice the NZCC tends to be careful and responsible in this regard and we have not seen that happening under the current or other previous Chairs of the NZCC.

Question 33 - Do you agree that there is a continued need for a settlement process, but a reduced need for an ad hoc adjudicative process such as the cease and desist regime, compared to the position in 2001? Please explain why / why not.

5.15 Yes.

Question 34 - Do you agree with the way that the Ministry has described the alignment and misalignment of the settlement process under the Commerce Act, on the one hand, with settlement processes under other legislation enforced by the NZCC, on the other? Please explain why / why not.

5.16 In part. While we agree that there are differences between settlement under the Commerce Act and settlement under other Acts enforced by the NZCC, it is Russell McVeagh's view that the settlement process under the Commerce Act is not misaligned with those Acts. Rather, the settlement processes under each Act have been designed in contemplation of the different aims and needs of each respective Act.

5.17 Enforceable undertakings were introduced to the Fair Trading Act in 2013 after substantial review of consumer legislation by the Ministry of Consumer Affairs in 2010. This was in part because the NZCC was increasingly using settlement agreements as an enforcement tool and, though it had never encountered a party to an agreement failing to adhere to the terms of the agreement, it was concerned the NZCC would face difficulty if this occurred in the future.[37] The NZCC was particularly concerned with its ability to gain redress for customers (for example, when the settlement agreement provided refunds for consumers).[38]

5.18 The NZCC's concerns that the 2013 Fair Trading Act Amendment sought to address are not relevant in the Commerce Act context. First, settlements under the Commerce Act are relatively infrequent compared to settlements under the Fair Trading Act.[39] Second, the Commerce Act does not provide for refunds to be paid to consumers, and in no case has a settlement agreement under that Act provided refunds for consumers.

5.19 It is Russell McVeagh's submission that any amendments to alternative enforcement mechanisms in the Commerce Act should be made with the particular risks and

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[36] This provision has only been used once, in the *Northport Ltd* case brought before the Cease and Desist Commissioner in 2006.

[37] Ministry of Consumer Affairs *Consumer Law Reform Additional Paper: Enforcement of the Fair Trading Act* (February 2011), linked here at [6].

[38] Ministry of Consumer Affairs *Consumer Law Reform Additional Paper: Enforcement of the Fair Trading Act* (February 2011), at [16].

[39] According the out of court settlement decisions listed on the NZCC website, there have been 8 settlements under the Commerce Act and 25 settlements under the Fair Trading Act.

challenges of competition law enforcement in mind, rather than on the basis of alignment with consumer protection (or other) legislation.

Question 35 - Do you agree that the cease and desist regime is misaligned with other relevant legislation?

5.20 No. Although Russell McVeagh agrees that there are the differences described between the use of the cease and desist regime in other legislation, for the same reasons given in response to Question 34, Russell McVeagh would not class this as a misalignment.

Question 36 - Do you think that the cease and desist regime unduly duplicates the (interim) injunction process?

5.21 No. As set out in Table 4 of the Issues Paper, the test that is required for the granting of an injunction is different from that which would apply at a cease and desist hearing. Depending on the qualifications of the Commissioner, it should also be quicker due to the higher level of expertise and experience of the Commissioner in Commerce Act specific matters.

5.22 These differences were also highlighted by the Ministry of Consumer Affairs in its discussion paper on the *Review of the Redress and Enforcement Provisions of Consumer Protection Law*.[40] In that paper, the Ministry of Consumer Affairs considered that "in comparison with the court process, cease and desist orders are low cost, can be introduced quickly, and prevent continuing cost to the economy, consumers and compliant businesses."[41] This is likely to still be the case today, and, to this end, cost and speed also provide a point of difference between the cease and desist regime and the injunction process.

Question 37 - Given the criteria for assessment it has used, is the Ministry's assessment of the current New Zealand approach to alternative enforcement mechanisms well-reasoned?

5.23 We agree with many aspects of the Ministry's approach and assessment as set out above. However, we caution against over-emphasis on alignment with other statutes.

Question 38 - If you are submitting that the criteria for assessment should be different from those used by the Ministry, how might the assessment be different using your preferred criteria?

5.24 Russell McVeagh suggests adjustments to the criteria used (set out in response to Question 25, above) that would assist a review of the enforcement mechanisms.

Assessment under additional criteria

5.25 Assessment of the enforcement regime would be different using the following additional criteria:

(a) **Checks and balances.** The requirement that financial penalties be included only with the approval of the High Court provides a check on the NZCC's power to impose penalty-like sanctions on defendants. Indeed, this aspect of the settlement regime does not weaken the regime, but acts to provide appropriate limits on the NZCC's powers.

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[40] Ministry of Consumer Affairs *Review of the Redress and Enforcement Provisions of Consumer Protection Law: International Comparison Discussion Paper* (May 2006), linked here.
[41] At p 33.

Question 39 - Do you agree with the Ministry's conclusion? Please explain why.

5.26 Russell McVeagh broadly agrees with the Ministry's conclusion. We would add that, in our view, factors such as the necessity of High Court approval for financial penalties do not weaken the settlement regime, when the settlement regime is assessed against the criteria of procedural fairness and the appropriate scope of NZCC power.

Question 40 - Do you have any other comments you wish to make about the Ministry's approach to assessing the current approach to alternative enforcement mechanisms under the Commerce Act?

5.27 No.

Question 41 - Which of the potential options identified would you like to see discussed if the Ministry publishes an options paper next year? Please explain why these options would be worthy of consideration.

5.28 As above.

Question 42 - Which of the potential options identified would you NOT like to see discussed if the Ministry publishes an options paper next year? Please explain why these options would not be worthy of consideration.

5.29 It is hard to see any benefit in considering removing the settlement regime.

Question 43 - Are there any other potential options that the Ministry should consider? For example, could better use be made of arbitration proceedings under the Arbitration Act 1996?

5.30 Yes, as discussed in response to Question 23, it is Russell McVeagh's view that it is worth considering whether creation of a Hearings Officer role would be of assistance in enforcing the Commerce Act. This role has been successfully developed by, for example, the European Commission and UK Competition and Markets Authority. The role ensures that in any alternative enforcement mechanism (ie cease and desist orders, court enforceable undertakings, settlements, etc) appropriate consideration is given to the protection of natural justice, procedural rights, privilege and rights of appeal. This is especially important when alternative enforcement mechanisms lead to outcomes that are not subject to the protections of judicial scrutiny and process.

Question 44 - In the event that an options paper is issued, what criteria should the Ministry use to assess the options set out in the Issues Paper? In principle, should they be the same as whatever criteria are finally used to assess the adequacy of the New Zealand regime?

5.31 Yes. As above, in response to Question 25.

6. MARKET STUDIES

Question 45 - Do the approaches to market studies described in the Issues Paper align with a gap in New Zealand's institutional settings for promoting competition?

6.1 No.

There is no gap in New Zealand's institutional settings for promoting competition

6.2 The NZCC and the Productivity Commission have powers of inquiry which enable them to conduct market research. There are also other market studies functions (as

discussed in the Issues Paper), which enable market studies to be conducted by other bodies. As a result, there is no gap in New Zealand's institutional settings for promoting competition.

6.3 The Productivity Commission has sufficient powers of inquiry that enable it to inquire into whether markets are operating efficiently. Because the Productivity Commission was established to advise the government on improving productivity in New Zealand, it is well suited to conducting market inquiries related to competition law.

6.4 It is likely the Productivity Commission was established with at least the partial purpose of it being able to conduct inquiries into competition law issues. This is illustrated by the fact that the Australian Productivity Commission, on which the Productivity Commission is modelled, has conducted inquiries focused on competition issues, including conducting a study on Australian and New Zealand competition and consumer protection regimes[42] and conducting an inquiry into whether Australia has the right balance between promoting competition and protecting intellectual property.[43] Further, the New Zealand Productivity Commission has inquired into and made recommendations on competition law. For example, in the international freight transport services inquiry, the Productivity Commission recommended the removal of the exemption in the Commerce Act that exempts contracts for carriage of goods by sea.[44]

Cost of market studies outweighs the benefit

6.5 Additionally, while there are benefits to policy makers in having information about market dynamics, overseas experience indicates that the cost of market studies would likely outweigh any benefits to consumers.

6.6 This has been the case in the United Kingdom, where market studies have been the subject of criticism due to the amount of taxpayer resources they consume and the significant costs they impose on firms in the industries subject to the market studies.[45] The UK Competition Commission (now the Competition and Markets Authority) has noted that: *"A company's external costs in a typical … Competition Commission investigation can be over £4m and internal costs over £2.5m*".[46]

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[42] Productivity Commission *Australian and New Zealand Competition and Consumer Protection Regimes* (13 January 2005), linked here.

[43] Media Release *Productivity Commission inquiry into Australian intellectual property arrangements* (18 August 2015), linked here.

[44] 2011/12 Financial Review of the New Zealand Productivity Commission at p 4. This recommendation was accepted by the Government in principle.

[45] Great Britain: Parliament: House of Commons: Trade and Industry Committee, "*The Work of the Office of Fair Trading: Twelfth Report of Session 2006-07 - Report, Together with Formal Minutes, Oral and Written Evidence*" (Paperback) at page EV52.

> On setting the OFT's priorities for market inquiries, we consider the essential test is whether they are a sensible use of the public purse and provide value for money. Put another way, could the National Audit Office be satisfied that there is a clear cost benefit? **Responding to an OFT market inquiry and a subsequent CC market investigation is extremely costly for the companies concerned.** This is in terms of external advisor costs, and a great deal more in terms of the huge diversion of management and employee resources.
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> ...
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> **In terms of market studies there is an equal need to ensure that they are value for money and priorities are set accordingly. Particularly in view of the OFT's admitted resource constraints there must be clear evidence that a market study is needed and will represent value for money and not just that it is an interesting market to study.**

[46] OECD Policy Roundtables, Market studies, (2008b) at p.202, available at: http://www.oecd.org/regreform/sectors/41721965.pdf

6.7 The most analogous NZCC investigation to a market inquiry, the NZCC's four year investigation the electricity sector,[47] was the single most expensive investigation in the NZCC's history, with the costs to the NZCC (let alone the businesses investigated) of that process understood to be in the millions,[48] which would not be out of line with the costs identified to be regularly incurred in the UK and Australian market investigation processes. In that instance, the NZCC found no evidence of breaches of the Act, but issued one warning regarding a risk of a breach. Other wide ranging NZCC investigations, that could be considered akin to a market study, have cost market participants hundreds of thousands of dollars, and have resulted in no finding of a breach and/or no proceedings being brought under the Commerce Act.

6.8 A key concern for New Zealand in particular is that market studies are highly resource intensive from the agency's perspective. In this regard, it presents a serious risk of diverting the already scarce resources of the NZCC from undertaking its core functions. If the NZCC does not obtain additional, separate funding to conduct market studies, then we are confident this power will result in a hampering of its ability to conduct investigations, process clearance applications and carry out enforcement of the Commerce Act.[49] These resources are already considerably stretched through the diversification of the NZCC's functions, and we see this impact in effect already with the high burden of regulatory functions that the NZCC has been required to commit extensive resources to over the last five to seven - years in particular.

6.9 It is our view that the capabilities of the NZCC to enforce the Commerce Act will be even further limited if it is required to also conduct highly resource-intensive market studies.

6.10 In addition to capacity constraints, there are policy considerations that need to be weighed in considering whether to give the NZCC a market studies function. Where problems in a market can be more easily remedied by market studies, rather than traditional enforcement, the NZCC may choose to undertake market studies over taking enforcement measures. Consideration therefore needs to be given to whether this is good public policy.[50] The constitutional question of whether findings from a market study could be used for proving a breach of the Commerce Act would also need to be considered.[51] It would also be necessary to consider how market studies would be conducted, and findings from market studies implemented, where the industries subject to the studies are regulated industries.[52]

6.11 Finally, overseas experience also suggests that the burden of market studies will fall on particular industries that have a high profile with consumers (such as banking, insurance, retailing and telecommunications). The costs of a market study are likely to be borne by all market participants and those costs will invariably be passed on to consumers. This will result in market studies effectively being a tax on consumers in

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[47] The Commerce Commission investigated whether any participants in the wholesale or retail electricity markets may have breached Part 2 of the Commerce Act. The investigation was opened in late 2005 after a number of complaints about high electricity prices, large company profits, a perceived low level of competitive activity and allegations of anti-competitive conduct: http://www.comcom.govt.nz/the-commission/media-centre/media-releases/detail/2009/commercecommissionfindsthatelectri

[48] Commerce Commission Annual Report 2008/09, p15 notes that this was one of two significant unilateral conduct investigations closed in that year. In 08/09 unilateral conduct investigation expenditure was in excess of $2m and in 2007/08 it was $1.5m.

[49] Indig & Gal New Powers - *New vulnerabilities? A critical analysis of Market Inquiries Performed by Competition Authorities* (6 October 2013). Competition Law as Regulation, Di Porto and Drexl eds., Edward Elgar, 2013, at p 5 ("Assuming that adding MIs to the CAs regulatory plate was not accompanied by increased funding, diversifying the Authority's toolkit may result in diluting the resources designated to traditional tasks, leading to inferior performance and deterrence.")

[50] Above at n 30.

[51] Above at n 30, at p 13.

[52] Above at n 30, at p 14.

those industries and, as such, serious consideration should be given to any net benefit (or lack thereof) before the introduction of market studies is contemplated.

Question 46 - What procedural settings for a market studies power would best fit the identified gap, in terms of: a) Who may initiate a market study; b) Who should conduct market studies; c) Whether mandatory information-gathering powers would apply; d) The nature of recommendations the market studies body could make; and e) Whether the government should be required to respond.

6.12 It is Russell McVeagh's view that there is no gap. However, Russell McVeagh's response to Questions 46(a) to (e) are set out as follows.

(a) Who may initiate a market study

6.13 Market studies should only be initiated a referring Minister. This allows the agency to remain neutral as between markets and industries.

(b) Who may conduct market studies

6.14 If market studies into competition issues are to be conducted (in addition to the Productivity Commission's existing powers - see 6.3 above) it should probably be by the NZCC, as the NZCC has the experience, skills and resources to efficiently assess competition in markets.

(c) Whether mandatory information gathering powers would apply

6.15 Mandatory information-gathering powers would be necessary for market studies to generate any valuable output.

(d) The nature of recommendations the market studies body could make

6.16 The report should make recommendations only, but there does not need to be any limit on the type of recommendation that the NZCC may consider, in its opinion, may be helpful for the proper functioning of the market.

(e) Whether the government should be required to respond

6.17 No, although in practice it seems unlikely the Government would not respond to an inquiry initiated by a Minister.

Russell McVeagh
February 2016